

LEGISLATIVE AUDIT COMMISSION



Review of
Department of Lottery
Year Ended June 30, 2012

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REVIEW: 4409
ILLINOIS DEPARTMENT OF LOTTERY
YEAR ENDED JUNE 30, 2012

FINDINGS/RECOMMENDATIONS - 2

ACCEPTED - 1
IMPLEMETED - 1

REPEATED RECOMMENDATIONS - NA
PRIOR AUDIT FINDINGS/RECOMMENDATIONS - NA

This review summarizes the auditors' report on the Department of Lottery for the year ended June 30, 2012, filed with the Legislative Audit Commission June 19, 2013. The auditors conducted a financial audit in accordance with *Government Auditing Standards*. Auditors stated the financial statements were fairly presented.

The Lottery began its operations as part of the Department of Revenue in 1974. In 1986, the Lottery was separated from the Department of Revenue and established as the Department of the Lottery. In 2003, the Lottery was established as a Division within the Department of Revenue. In 2011, the Lottery operations transitioned to a private manager, Northstar Lottery Group, and effective October 15, 2011, the Department of Revenue transferred all functions, powers, duties, rights and responsibilities to the Department of the Lottery. As a means of easing and transitioning, management elected to use an effective date of July 1, 2011 for the financial accounting and reporting.

For the first 14 weeks of the one-year period, Victor Golden served as Acting Superintendent of the Lottery. Michael Jones became Superintendent effective October 10, 2011. He continues to serve in that position. Mr. Jones ran the Illinois Lottery from 1981 to 1985.

Financial Information

The Appendix contains the Statement of Net Assets and Revenues, Expenses, and Changes in Net Assets for FY12 only since Department responsibilities were transferred from the Department of Revenue effective July 1, 2011. Total net assets at June 30, 2012 were \$24.3 million.

Accountants' Findings and Recommendations

Condensed below are the two findings and recommendations presented in the report. Responses to the recommendations are classified on the basis of updated information provided by Melinda Westwater, Chief Internal Auditor, via email on October 22, 2013.

Accepted or Implemented

- 1. Implement procedures to ensure GAAP Reporting Packages and financial statements are prepared in an accurate and complete manner. Allocate sufficient staff resources and follow formal procedures to ensure GAAP financial information is prepared and submitted to the Illinois Office of the Comptroller in an accurate manner, and maintain supporting documentation in a contemporaneous manner to support the financial information being reported.**

Finding: The Department of the Lottery's year-end financial reporting in accordance with generally accepted accounting principles (GAAP) to the Illinois Office of the Comptroller contained numerous errors/inaccuracies and incomplete data, some of which are noted as follows:

- During planning for the financial audit, the auditors inquired of Lottery management to obtain an understanding of the general control environment over financial reporting. Though the Lottery has formal procedures related to the accumulation and processing of financial information, the auditors noted weaknesses. Specifically, (1) not all manual journal entries were reviewed by a person other than the preparer, (2) certain account reconciliations were not prepared or maintained, (3) account reconciliations, when performed, did not document that they had been reviewed by a person other than the preparer, and (4) supporting documentation that agreed to amounts in the financial records was not always readily available.
- Historically, Lottery had made cash transfers to the Common School Fund in excess of their income before transfers. These excess cash transfers were reported as "Due from Other State funds" in the Lottery's financial statements. During testing, the auditors noted the "Due from other State funds", did not meet the criteria for being reported/recorded as a receivable. Subsequently, the Lottery, in conjunction with the Illinois Office of the Comptroller, concluded the balance should be eliminated and considered a prior period transfer. This account was reported in the Lottery's accounting records to the auditors with a balance of approximately \$69.9 million.
- The auditors noted the prizes payable liability balance did not agree to underlying/supporting records. During Department management's subsequent review of the data, missing reconciling items were identified. One item identified resulted in an overstatement of the liability of \$30.3 million.
- For Transfers to Capital Projects Fund, the Illinois Lottery Law requires the Lottery to distribute all proceeds of lottery tickets and shares sold in a specific priority and manner. The last priority requires the Lottery to transfer any remaining proceeds to the Capital Projects Fund on or before the last day of each fiscal year. Since the change in the Lottery Law, the Lottery has made an estimate of the remaining

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proceeds and made the required transfer based on that estimate. As a result of normal end-of-year financial adjustments and completion of the annual audit, there has been a difference between transfers of estimated remaining proceeds and actual net income. As of June 30, 2012, the Lottery has recorded a balance of \$18.6 million due to the Capital Projects Fund, reflecting actual net income in excess of amounts previously transferred to the Capital Projects Fund through that date. The Lottery needs to establish a policy to allow for amounts deposited into the Capital Projects Fund at the end of each fiscal year to be adjusted in the subsequent fiscal year to reflect the final distributions due. This amount should be based upon the actual results of operations for such fiscal year. The policy should be supported by the Lottery Law and legal determinations.

The aggregate impact of all of the adjustments made since the initial June 30, 2012 GAAP Reporting forms were submitted to the Illinois Office of the Comptroller was a \$63.0 million increase in assets, a \$45.7 million decrease in liabilities, a \$106.3 decrease in expenses and a \$1.5 million increase in revenue.

Lottery management indicated the errors and inaccuracies noted were due to the fact that during FY12 the Lottery began efforts to deconsolidate from the Department of Revenue. A number of retirements and turnover of staff created opportunities for a lack of continuity of key processes and procedures. Also, the Lottery was in transition to a Private Management Agreement with a third-party vendor to market and sell Lottery tickets and a new gaming computer system, which also created additional challenges. In addition, the Lottery also transitioned to a new data reporting system that resulted in the Lottery receiving data in report formats that did not mirror the previous system reports and led to initial inaccuracies and delays in data presentation.

Updated Response: Implemented. The Lottery has worked with Shared Services to review current procedures and has made the necessary revisions to ensure GAAP financial reporting and financial statements are prepared completely, accurately and timely with appropriate supporting documentation. The Lottery has also worked with Shared Services to ensure sufficient staff resources have been allocated to the process from both Shared Services and the Lottery and that procedures are properly followed.

2. Implement and document the controls over the computing environment and ensure the controls provide sufficient protection against unauthorized access and inappropriate changes. Specifically:

- **Implement a method of logging to track any system changes migrated to production over a given period of time and verify that changes were tested and approved appropriately. Use testing evidence and business approvals to support any changes moved to production. In addition, document use of key logging software, and limit, review and retain access to the log.**

Accepted or Implemented – concluded

- **Segregate the development activities from migration activities. Develop and implement compensating controls if segregation of duties is not feasible.**
- **Review system access rights on a periodic basis, retain evidence of review, and document and timely apply any changes noted.**
- **Ensure password requirements such as length, expiration, lockout, and complexity adhere to Department policy.**
- **Develop a security policy for all applications.**
- **Eliminate 24/7 access to the Drawing Room for maintenance employees.**

Finding: The Department had not implemented controls over its computing environment to ensure sufficient protection from unauthorized access or inappropriate changes. Specific areas where weaknesses were identified were as follows:

Change Management
Segregation of Duties
Documented Access Reviews
Password Complexity
Security Policy
Excessive Access Rights to the Drawing Room

Department management indicated that during FY12, the Lottery began efforts to deconsolidate from the Department of Revenue. A number of retirements and turnover of staff created opportunities for a lack of continuity of key processes and procedures.

Updated Response: Accepted and partially implemented.

- Change Management - The Lottery has implemented a method to track system changes migrated to production over a given period of time and verify that changes were tested and approved appropriately. In addition, use of our key logging software is documented; access is limited, reviewed, and retained.
- Segregation of Duties – The Lottery has implemented a compensating control that assures that development activities are clearly separated from migration activities.
- Documented Access Reviews – The Lottery has begun reviewing system access rights and maintaining evidence of review on a periodic basis.
- Excessive Access Rights to the Drawing Room – The Lottery has restricted access to its draw room to only key personnel.

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- Password Complexity – The Lottery agrees with the recommendation and as a compensating control ensures that the computer access points used to access key systems comply with the Lottery's password policy. Lottery will continue to work with key system providers (where possible) to address system specific concerns.
- Security Policy - The Lottery agrees with the recommendation and has begun to research the requirements to develop a comprehensive security policy for its applications.